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UNCLAS SECTION 01 OF 03 PRISTINA 000522

SENSITIVE
SIPDIS

DEPT FOR EUR/SCE, EUR/PGI, INL, DRL, PRM, USAID

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SUBJECT: KOSOVO: NEW KOSOVO POWER PLANT REIGNITED

REF: PRISTINA 404

PRISTINA 00000522 001.2 OF 003

SENSITIVE BUT UNCLASSIFIED - PLEASE PROTECT ACCORDINGLY

11. (SBU) SUMMARY: After several months of delay and intensive background work in Washington, Brussels and Pristina, the long-overdue restructuring of Kosovo's energy sector appears to be reinvigorated thanks to two recent decisions. On November 13, the Government of Kosovo (GOK) finalized a contract with the International Finance Corporation (IFC) to be the transaction advisor for the privatization of the Kosovo Energy Corporation's (KEK) distribution and supply network (DistCo). On November 17, the New Kosovo Power Plant (NKPP) Project Steering Committee (PSC) agreed to endorse a smaller new generation project and established an aggressive timeline to release new tender documents for the project by mid-February 2010. These are extremely welcome developments, as well as key steps toward realizing a project that will significantly improve Kosovo's economic growth and reduce the burden on the Kosovo Consolidate Budget (KCB) while at the same time improving Kosovo's carbon footprint. END SUMMARY

12. (SBU) As reported reftel, three years have passed since the start of the NKPP project, with the process almost coming to a halt this past summer. After the GOK and key international stakeholders reached agreement on a transaction structure, two pre-qualified consortia publicly announced their withdrawal from the process and the viability of the project was questioned. In the meantime, changing attitudes toward global climate change threatened to preclude international development bank financing for new coal projects, potentially jeopardizing Kosovo's ability to utilize its vast lignite resources to meet domestic needs. However, after several months of intensive background work in Washington, Brussels and Pristina, two major breakthroughs within days of each other appear to have reinvigorated Kosovo's much-needed energy sector reform.

DISTCO TRANSACTION ADVISOR ENGAGED

13. (SBU) On November 13, the GOK finalized an agreement with the IFC to become the transaction advisor for the privatization of KEK DistCo. Since the GOK had failed to contract a transaction advisor for DistCo privatization twice already, this was an important step forward. The success of NKPP is dependent upon the existence of a

reliable network and supply distributor, a role the privatized DistCo is envisioned to fulfill. IFC has already commenced work and has begun its analyses to develop and recommend a preferred structure for the DistCo transaction. IFC plans to prepare these recommendations by mid-February and implement the transaction on an expedited schedule. The goal is to make an award by Autumn 2010. The IFC will work closely with all donors and stakeholders involved in Kosovo's electricity sector, including USAID, the World Bank (WB) and the European Commission (EC).

NKPP PROJECT TO START SMALL

¶4. (SBU) The following week, a PSC meeting for the World Bank-funded NKPP was held on November 17. The session was chaired by the Minister of Energy and Mines, and observers from the WB, EC and USAID were also in attendance. Lead by new personnel from the NKPP transaction advisory company PricewaterhouseCoopers, the PSC took key decisions on the structure of the proposed transaction and identified an aggressive timeline for tendering the project. Taking into account prevailing attitudes toward global climate change but also Kosovo's need for new generation to meet growing domestic demand, foster economic growth and reduce the strain on the KCB, the PSC endorsed a smaller new generation project of 500 MW. This is a reduction from the 1000 MW of initial generation capacity announced in July 2009. The PSC also reaffirmed their expectation that the new project will meet the highest international standards and reduce Kosovo's net carbon emissions.

NKPP BIDDER POOL TO BE EXPANDED

¶5. (SBU) The PSC also considered the option of re-opening the pre-qualification process to new interested bidders. After the NKPP

PRISTINA 00000522 002.2 OF 003

transaction advisor (TA) presented the pros and cons, the PSC agreed with the TA's recommendation to re-open the process in order to expand the pool of eligible bidders. This action will be taken in coordination with an extremely ambitious timetable to prepare the documents needed for the initial draft Request for Proposals (RFP), which will be used to solicit feedback on the NKPP transaction from the pre-qualified consortia. In the current plan, the tender documents will be ready for release at the same time as the expanded pool of bidders is identified. The completion of these two actions is anticipated by mid-February 2010.

PSC BACKS "B-PLUS" OPTION FOR NEW GENERATION

¶6. (SBU) Moving on to the overall structure of the NKPP project, the TA presented an analysis of three potential tendering options that would meet Kosovo's key objectives for pursuing the project, as well as attract reputable investment. All scenarios presumed a smaller, initial new generation requirement.

-- Option one offered the northern half of the Sibovc mine concession and the building of new generation directly on the Kosovo A site. This option was discussed on November 9 at an unofficial PSC attended only by GOK representatives.

-- Option two involved the full concession of the Sibovc mine, with new generation to be built adjacent to Kosovo B. New generation in this scenario would be smaller, and remain separate from the existing Kosovo B facility.

-- Option three also recommended full concession of the Sibovc mine but with new generation being built adjacent to Kosovo B, and including "B" as an asset in the transaction. This option has been labeled "B-Plus".

After a short review of the benefits and challenges of each option, the PSC decided on B-Plus as the recommended way forward.

FAST-TRACK TIMELINE OUTLINED

¶17. (SBU) In order to execute these decisions as expeditiously as possible, the TA unveiled an accelerated timetable. The next PSC meeting will be held December 5, where the TA will present additional analysis to support the B-Plus option, and proceed to organize the process for Kosovo's key counterparts to address the full range of issues as needed to ensure a draft RFP can be prepared by mid-February. A draft of the pre-qualification document to expand the pool of interested bidders will be circulated before the next PSC meeting, with the goal of pre-qualifying additional investors by mid-February. A second PSC meeting in mid-December will finalize the B-Plus transaction structure after receiving initial market feedback, approve the pre-qualification document for issuance, and provide an update on the progress of the draft RFP preparation.

COMMENT

¶18. (SBU) The recent decisions by the GOK to move forward with both DistCo privatization and NKPP project restructuring have been long awaited. Discussions about the impact for Kosovo of a new global approach toward climate change and coal projects have been at the forefront of the GOK's mind. We applaud the efforts of all stakeholders to move this process forward, with a special thanks to our colleagues in Washington who have worked to develop a strategy that will meet Kosovo's development needs and satisfy climate change concerns. Although perhaps not foreseen as one of the outcomes of the environmental impact review, it had the useful corollary effect of moving the approaches of the U.S. and WB closer together around the new framework. We urge all stakeholders to keep the dialogue on Kosovo's energy sector reform alive, and continue to push this process forward to an expedient conclusion.

¶19. (SBU) COMMENT CONTINUED: For the overall success of the multi-track energy sector reform process, we must ensure, as the GOK engages these two transactions over the coming months, that there is a political champion who is committed to take the tough decisions

PRISTINA 00000522 003.2 OF 003

necessary to drive this process forward. The organization of periodic DVCs, linking the GoK, other Pristina-based actors, and Washington decision makers (including the Department, USAID, and the World Bank), could be one useful means to make certain that this policy process remains on track.

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